7/31/77

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THE PRESIDENT'S SCHEDULE

Sunday - July 31, 1977

9:50	Depart South Grounds via Motorcade en route First Baptist Church.
10:00	Sunday School.
11:00	Morning Worship Service.

Sunday night, 11:50 p.m.
July 31, 1977

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

MEMORANDUM

Presentation to public & Congress should begin with present horror story, & contrast with our proposal. Emphasize benefits to recipients.

TO: THE PRESIDENT

FROM: STU EIZENSTAT Stu

Attached is the joint welfare memorandum you asked us to coordinate. It has been reviewed by all pertinent agencies.

1. At my request, there is a budget overview section. I strongly believe you should make your decisions on welfare reform in the context of budget realities over the next 4 years. With the EITC considered on the tax side of the ledger, Charlie believes there is $10 billion for "new programs" or add-on spending above inflationary increases over the next 4 years. Some of this should be used for welfare reform. The major add-ons suggested to the basic program would cost $1.56 to $2.1 billion in FY 1981 -- the first year of budget impact. The EITC would cost $3.7 billion but would be considered as part of the $30 billion in tax reductions Charlie believes will be necessary from now until 1981.

2. It appears Congress will not be in session Saturday, so this proposal should go up on Friday. (A drug abuse message and illegal alien message will also go up this week.) Joe wants to have the Congressional leaders, key Mayors, and Governors in the night before or morning of the message.

3. After you have made your decisions on the matters covered by the attached memorandum, we will quickly provide you with a brief point-by-point summary of the approved plan. This cannot be done now, in a way which would be helpful, until you make the decisions mentioned herein.

4. This plan is the most frugal possible. Your "no cost" directive has had an exceptionally good impact from a discipline standpoint. The plan puts primary emphasis on jobs, with cash assistance improved by including, on a national basis, for the first time, intact families.

5. The first 4 add-ons suggested in the memorandum are very important, if there is to be any chance to sell this program and to be perceived as dealing compassionately with current recipients. However, you should recognize that some black and liberal leaders will nevertheless criticize the plan as inadequate in fiscal relief, benefit levels and wages.

6. It is important to recognize that the 1.1 million public service jobs in the plan are affordable only because these "minimum wage" jobs will supplant the 725,000 "prevailing wage" CETA jobs which we will have in FY 1978 as part of the stimulus package and which are designed to terminate thereafter. One concern is whether Congress will be willing to phase these out, particularly if unemployment is still high by then. This, of course, is a battle for another day.

7. The cooperation of all persons involved, including Tom Joe, has been exceptional.

Attachment

THE WHITE HOUSE

WASHINGTON

July 31, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: Joe Califano
Ray Marshall
Charles B. Schultze
Stuart Eizenstat

SUBJECT: Welfare Reform Decision Memorandum

Following our meeting on Thursday, you raised questions about several aspects of the HEW-DoL Welfare Reform proposal. This memorandum sets out a budgetary framework for your decision and discusses the following issues:

- Costs of the basic welfare reform proposal and possible offsets;
- Possible alternatives to the proposed benefit structure, including a lower basic benefit;
- Options for State cost sharing in cash assistance and/or State maintenance of cash assistance effort;
- The Earned Income Tax Credit;
- A recapitulation of HEW-DoL recommendations that additional provisions -- costing additional funds -- be included in the final welfare reform package.

I. The Budgetary Context

Charles Schultze has written a memorandum, in which OMB concurs, describing the budgetary framework for welfare decision-making. It is attached at Tab A. The conclusion of the memorandum is as follows:

Given important areas of budgetary uncertainties -- in the estimates, in the pressure to cover inflation in grant programs, in the fate of the energy package, in the magnitude of savings from zero-based budgeting -- it would be prudent, at this stage, to assume that no more than $10 to $15 billion of expenditure margin will be available in 1981. This must accommodate the first phase of health insurance, some outlays (probably modest) for fiscal aid to cities, as well as any added outlays on welfare reform over and above the zero-cost program. With good breaks, and significant savings from zero-based budgeting, that margin could widen. But between now and 1981 there will surely be new needs, unforeseen emergencies, and attractive opportunities to contend with and to consider. Over the next year, therefore, we certainly shouldn't commit to added 1981 expenditures beyond $10 billion.

Summary of 1981 Budget Margin

Total	50
Tax reductions	30
. Full Treasury reform package	28
. Added earned income tax credit	3-1/2
Expenditure increases	20
. Allowance for inflation in current programs	5
. Contingency for future threats, needs, etc.	5
. Expenditure leeway for current decisions	10

In short, the full menu of Treasury tax reform proposals, together with the Earned Income Tax Credit, would more than consume the allowance for tax reduction. Additional expenditures for welfare reform, above "zero cost," would be charged against the $10 billion expenditure leeway. However, this is the type of highly significant program for which you may wish to use some part of this leeway. It will have no budgetary impact until FY 1981.

II. Costs and Offsets

OMB, HEW and Labor have reached agreement on program costs and possible offsets.

A. Costs

The present costs of the basic welfare reform proposal are:

Cash Assistance	$19.5 billion*
Earned Income Tax Credit	1.5 billion**
Employment and Training Program	8.2 billion
	$29.2 billion

Proposal-cost at Present

The cost total differs slightlyfrom the estimate in HEW's July 25 memorandum ($28.9 billion) to reflect adjustments agreed upon by OMB and HEW.

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* The system will experience somewhat higher initial year overpayment rates and, in addition, there will be greater initial year administrative costs than the $2.2 billion included in the $19.5 billion estimate. These added costs are, however, approximately offset by relatively low participation rates projected for the early years. The $19.5 billion cost estimate reflects mature program -- and thus higher -- participation rates.

** Below the entry point of the positive tax system. Additional costs above the tax breakeven point of $3.4 billion are discussed below.

29.2
27.4
1.8

29.2
28
1.2

B. Offsets

The present agreed offsets to costs are:

Aid to Families with Dependent Children	$6.4 billion
Supplemental Security Income	5.7 billion
Food Stamps	5.0 billion
Earned Income Tax Credit	1.3 billion
Stimulus Portion of CETA Jobs and Win	5.9 billion
Increases in Social Security Contributions	.3 billion
Decreases in Regular Unemployment Insurance Outlays	.4 billion
Savings Within HEW Budget	.4 billion
Well Head Tax Revenues	1.3 billion
Extended Unemployment Compensation from 26-39 Weeks	0.7-1.3 billion*
	27.4-28.0 billion

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* The $1.3 billion costs of extended unemployment compensation in FY 1978 have consistently been allocated to the "zero cost" proposal in our discussions with you. This represents a decision to put a trigger on extended benefits so that the extra weeks will not be available under the economic conditions projected for FY 1981. However, because unemployment is projected to be lower in FY 1981 than in 1978, the actual FY 1981 savings of eliminatingthe program are projected to be $700 million. The additional $600 million will reduce the budget margin for other programs.

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One additional issue regarding offset to costs requires your decision:

Reduction in HUD Expenditures

Everyone but HUD agrees that there will be $.5 billion in HUD outlays saved as a result of increased cash/jobs assistance. (As income of welfare/jobs recipients increases, HUD subsidies decrease.) Everyone but HUD also agrees that these savings should be allocated to the welfare reform cost base.*

Decision

Allocate the $.5 billion savings in HUD outlays to welfare reform cost base.

✓ Approve (OMB, CEA, HEW, Labor, Domestic Policy Staff recommendation) J

______ Disapprove (HUD recommendation)

If you approve the use of the $.5 billion in HUD outlay savings, the net cost of the basic welfare reform proposal will be $700 million - $1.3 billion, to be allocated against the budget margin.

III. Benefit Structure

A. Reducing the Basic Benefit

Issue: During last Thursday's meeting, you asked how much could be saved by reducing the basic Federal benefit and, if no additional monies were available, whether HEW would prefer to keep its proposed benefit levels and not have any of its proposed program modifications.

Possible Solution: HEW has considered dropping the basic Federal benefit for everyone on cash assistance except the aged, blind and disabled by approximately $200 ($4200 to $4000 for a family of four).

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* Two points should be noted:

1) This is merely an accounting matter and does not in any way reduce HUD's budget. It is not one of the contested OMB-HUD-HEW proposals (cashing out of housing subsidies; imputation of housing subsidy income under Section 8). It simply is a way of realistically looking at the cost of the program.

2) Many of the staff at HUD agree with the suggested allocation.

This step would save approximately $1 billion in the Federal program. But it would cost the States approximately $.5 billion to supplement AFDC and SSI recipients who are made worseoff by the reduction up to current levels through congruent supplements. And it would make approximately 100,000 food stamp and general assistance recipients worse off.

Problems: Not only would a reduction in the basic Federal benefit increase worseoffness (in a plan with nearly nine million recipients potentially worseoff) and reduce fiscal relief, it would lead to sharp attacks on the plan from liberal groups. A central problem with the reduction is that it would make benefit levels for the expected to work group lower in many instances than benefits provided under the current food stamps program.

We believe that a far better way to save money within the present program structure is to require States to pay 10% of the costs of the basic Federal benefit (i.e., 10% of $4200 for a family of four). This measure would save $1.8 billion and is discussed below.

Conclusions:

- The basic Federal benefit should not be reduced.
- It is more important to retain the benefit levels outlined in HEW's July 25 memorandum and not have any of HEW's proposed additional program modifications than to reduce benefits in order to finance those modifications.

Decision

_________ Reduce basic benefit by $200.

✓ Retain benefit levels proposed in July 25 memorandum. (Recommended)

J

B. The Well Head Tax

As you know, $1.3 billion from the well head tax will be used as an offset to welfare reform expenditures.

We propose to build the cash assistance plan on top of the well head tax rebate. As outlined in the July 25 memorandum, the basic Federal benefit of $4200 for a family of four included $180 (four times $45) from the well head tax.* ?

Decision

_______Approve proposed treatment of well head tax rebate. (Recommended)

_______Disapprove

Spell out on basis of energy message

not firm -

C. Indexing

Problem: The HEW/DoL proposal recommends that Federal cash assistance benefits be indexed to the Consumer Price Index (CPI) to ensure that the real value of benefits are not eroded by inflation. This would follow current policy under SSI, Social Security, and Food Stamps (but not AFDC) and would offer some protection to our poorest citizens who are least able to protect themselves against inflation. As the July 25 HEW memorandum indicates, without indexing a $4200 basic benefit would decline in purchasing power to $3031 in five years. HEW feels that the real incomes of those least able to provide for themselves should not depend on discretionary adjustments. Indexing involves no addtional program cost in "real" terms. In addition, a decision not to index would represent a substantial de-liberalization of the currently indexed SSI program, which would be highly controversial with the elderly and disabled constituencies. Your staff agrees with these arguments.

The July 27 CEA memorandum expresses reservations about indexing, pointing out that the tax system -- to which the cash assistance program is tied -- is not automatically indexed, and suggesting that indexing will reduce flexibility in making discretionary changes in benefit levels as program experience is gained.

CEA suggests that you issue a strong statement in your message that you will not let the real value of aggregate cash assistance benefits decline, but that you want to retain flexibility in distributing this increment.

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* This is consistent with the national energy plan you proposed to Congress, under which the wellhead revenues were to be rebated on a per capita basis to taxpayers and non-taxpayers. The proposal here reflects that provision of the energy plan.

Decision

_____ Index benefits to CPI. (HEW, Domestic Policy Staff recommendation) ?

✓ Do not index benefits now, with a strong Presidential statement that the Administration will not let aggregate real value of benefits decline. (CEA, DoL recommendation)

_____ Do not index benefits, no statement.

IV. Proposed Changes in the Structure of the Plan as Presented July 25.

Transition Period: We are troubled by one aspect of the plan as presented July 25: The tradeoff between fiscal relief and "worseoffness" among those currently served by welfare programs.

- o If States do not supplement at all, they would realize $7.3 billion in fiscal relief (their current contribution in AFDC, SSI Supplements, and general assistance).

- o If States provide supplements parallel to our basic plan and "grandfather" SSI recipients as we expect, they will realize $3.7 billion in fiscal relief. However, 6.5 million existing AFDC recipients (25% of them below the poverty line) would lose benefits averaging $300 each (the loss for families would be greater). In all, about 9 million people now receiving some welfare benefits would be "worse off".

In all likelihood, States will not only supplement parallel to our system, but also reinvest a substantial share of the $3.7 billion in potential relief to ease the transition for AFDC'ers into the new system by those now receiving benefits.* But under our plan, as it stands, there is no firm reassurance to offer those existing recipients who stand to lose.

We propose a 3-year transition period in which States will be required to contribute 90% of their current welfare expenditures in the first year -- effectively limiting fiscal relief to 10%. The 90% figure would decline to 60% in the second year, 30% in the third, and 0% in the fourth.

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* If all States provide congruent cash and wage supplements and grandfather SSI and AFDC recipients, total fiscal relief drops to slightly over $1.1 billion. We will also be attacked for leaving AFDC recipients to the mercy of States for protection against benefit reductions.

States would be required to expend these funds as follows:

- o on congruent (parallel) supplements;
- o on "grandfathering" SSI recipients;
- o on easing the transition for current AFDC recipients, through limited forms of "grandfathering".

Except for SSI grandfathering, allocation of funds among these uses would be at the discretion of the States. This would not alter the probable allocation of funds in most States, but it would allow us to say that the maximum fiscal relief would be $730 million in the first year, and that -- in general -- strong incentives have been provided to ease the transition for current AFDC recipients. AFDC rolls "turn over" by about 1/3 per year.

We recommend adoption of this approach. Secretary Califano believes strongly that we must make every effort to deal with the "worseoffness" problem, especially for those below the poverty line, even at the cost of initial year fiscal relief.

The advantage of this new proposal is that, without increasing the Federal cost of the program, it permits short-term protection of AFDC recipients, and creates a gradual transition to the new system for them. By the end of the third year, States and localities will have as much fiscal relief as originally proposed and AFDC recipients will be in the same posture; but their burden will be eased by the transition. This will also help blunt the expected criticism of the worseoffness problem our proposal creates.

You should recognize, however, that this revision does not seek to protect all AFDC recipients, and would not require States to hold harmless those AFDC recipients with high earnings relative to other recipients.

Decision

✓ Approve (recommended)

______ Disapprove

Matching the Basic Federal Benefit: Under the plan as submitted July 25, there is no State contribution in the basic $4,200 benefit, with 25% State cost-sharing from $4200-$4700, 75% State cost-sharing from $4700-poverty line and full State cost above that level.

In the 12 States which are not expected to supplement, we could have State administration of the program with no State financial incentive to ensure that benefits go only to those eligible. In these States, the proposed Federal benefit exceeds the current combined State-Federal payment for SSI, AFDC, and Food Stamp recipients.

We therefore propose a 10% State match in the basic $4200 benefit, with an adjustment designed to assure that no State must contribute more than 90% of its current expenditures. This would:

- o Improve administrative incentives; and
- o Save $1.3 billion for use in program improvements.

Even after the 10% match the States will have fiscal relief of $700 million in the first year. The maximum potential fiscal relief in later years would be reduced by the $1.3 billion cost of the State match.

We recommend tentative adoption of this approach, but note that State-by-State impact analysis is still underway. This will have the advantage of reducing the perverse reward in the initial program for low supplement States. ?

Decision

✓ Approve (recommended)

_______ Disapprove

Try to simplify

V. The Earned Income Tax Credit

Background: The Earned Income Tax Credit provides families a credit of 10 percent of earnings up to $4,000 per year. This credit is reduced by the excess of adjusted gross income over $4,000 per year. The credit reaches a maximum at earnings of $4,000 and vanishes at $8,000. A modification in the present Earned Income Tax Credit is an essential part of the welfare reform proposal for two distinct reasons.

First, the present EITC adds 10 percentage points to the benefit reduction rate for families with earnings between $4,000 and $8,000 per year. It may increase the combined benefit reduction rate (including Social Security taxes) in states that supplement cash assistance to a maximum of 68 percent for those "expected to work" and to a maximum of 86 percent for those "not expected to work" over this income range. These benefit reduction rates are serious work disincentives and would affect a substantial proportion of the cash assistance population.

Second, an increase in the Earned Income Tax Credit through the upper ranges of the cash assistance system makes it possible to provide all or most assistance to a significant number of families through a tax credit rather than through the cash assistance system. The EITC described below permitted us to reduce the point at which recipients leave the system about $400 from levels contained in the May 19 memorandum.

Without the EITC described below, it would be necessary to substantially redesign the cash assistance program presented to you in the July 25 memorandum.

The Compromise: As we presented it to you last Thursday, we propose to modify the EITC as follows: a 10 percent credit would be allowed on earnings up to $4,000 per year, as under current law; on earnings between $4,000 and the income at which the family would become liable for positive taxes, the family would receive an additional credit of 5 percent of earnings. Given the tax entry points proposed by Treasury a family of four would be eligible for a maximum credit of $654 at earnings of $9,080 in 1978 dollars. Benefits would reach 0 at $15,620 for a family of four and at $19,488 for a family of six.

In reaching this compromise, we tried to reconcile conflicting objectives.

- o We did not wish to reduce the existing EITC for any households. This dictated that the credit remain at least 10 percent up to $4,000.
- o We wished to hold down the combined benefit reduction rates in the cash assistance as much as possible in order to ensure adequate work incentives. This required that the EITC continue to increase on earnings up to the point at which households cease to be subject to the benefit reduction rates in the cash assistance system, which in most states and for nearly all classes of beneficiaries occurs at around the tax entry point.
- o We wished to hold down the rate at which the EITC is reduced in order to keep the sum of positive income tax rates, Social Security taxes and the phase-out rate of the EITC, (i.e., the <u>marginal</u> tax rate)* as low as possible (preferably below 40 percent). The compromise will keep combined marginal tax rates at 35 percent.
- o We wanted to keep the EITC from being available to earners with high incomes.

Providing a credit rate of less than 10 percent on earnings up to $4,000 violates the first objective. Providing a credit of less than 5 percent on earnings up to the tax entry point runs counter to the second objective. Reducing the credit above the tax entry point by more than 10 percent runs counter to the third objective, but it advances the fourth, because it would cause the EITC to vanish at lower earnings levels. Thus, the proposed compromise is 10-5-10: a 10 percent credit on earnings up to $4,000 per year; 5 percent for earnings between $4,000 and the level of entry into the tax system (around $8,000); and then a 10 percent phase-out for earnings above the tax entry level.

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* The marginal tax rate is a term used to describe the reduction in the amount which workers can take home of income above a given level.

On balance Treasury, CEA, HEW, Labor, and Domestic Policy Staff agree that the proposed credit provides an acceptable compromise among these conflicting objectives.

Cost

The cost of this proposal in 1978 dollars is estimated to be \$3.6-3.7 billion in excess of the \$1.2 billion now absorbed by the present EITC. These estimates are based on estimated 1979 incomes and tax entry points. The 1979 cost is deflated to 1978 dollars. Based on these assumptions, Treasury, CEA, and HEW agree that this is a reasonable estimate of cost.*

The amount of EITC going to recipients of cash assistance will rise \$200-300 million. The remaining cost, \$3.4 billion, will accrue to families with positive income tax liabilities. This will be a significant benefit to lower income workers.

Treasury reports that it is feasible to disburse the EITC through adjustments in withholding by employers. Adjustments would be made on tax returns for under- or over-payments.

Treasury agrees with the use of the EITC but would emphasize that the cost of the EITC in the positive tax range should be in addition to, not a part of, its present tax reform proposal. Note these do have different effective years -- 1979 for tax reform; 1981 for the expanded EITC.

Decision

1. The expanded EITC described above should be included in the welfare reform message and draft legislation.

___✓___ Approve (recommended) J

_______ Disapprove

2. The effective date for the expanded EITC should be the year of implementation of the reformed welfare system, (FY 1981).

___✓___ Approve (recommended) J

_______ Disapprove

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* If this were measured in 1981 dollars (the first year of the program), the cost would be somewhat less since, with inflation and real wage increases, there will be fewer people at income levels eligible for the EITC.

VI. Recommended Additions to the Basic Plan

Cash Assistance

The following proposals for changes in the cash assistance program are listed in order of priority. They are designed to remedy inequities to existing recipients, to lower the number of recipients whose benefits will be reduced, or to ease fiscal burdens on the States.

Two of the first four proposals -- the adoption of a modified family-based filing unit and a standard child-care deduction -- would have a substantial impact on the single biggest problem of politics and equity presented by the basic proposal: The number of existing AFDC recipients who will be made worseoff (assuming only congruent supplements) by the new plan.

If these proposed changes are adopted, the number of AFDC recipients made worseoff is reduced from 6.2 billion to 4.5 million; the total amount of the reduction in their benefits would decline from \$2.6 billion to \$1.8 billion; their reduction in disposable income would decline from \$1.9 to \$1.3 billion.

HEW believes that adoption of the first four modifications is very important to the political viability of the welfare reform proposal.

A balance sheet of costs with decision options is provided at the end of this section.

A. Children who reside with legally non-responsible relatives

Problem: The filing unit contained in the May 19 proposal would have precluded benefits on behalf of many "informal" foster children who live with relatives such as grandparents, aunts or uncles who are not legally responsible for the child. Under existing practice in most States, such children are allowed to receive benefits even if a relative with whom the child lives would not ordinarily be entitled to benefits. Both State officials and child welfare organizations are concerned that our proposal will discourage such desirable informal foster arrangements and increase the number of children placed in institutions.

Proposal: HEW proposes to allow a benefit for children living with relatives who are not legally responsible for the child, regardless of the relatives' income, in accordance with current practice.

Additional Cost: $160-200 million. ok J

Effect: This provision will provide Federal support averaging roughly $400 each for 250,000-300,000 children. Assuming the States would have provided support for these children in any event, this provision goes entirely for fiscal relief. Since not all States are likely to provide such protection, an undetermined part of the Federal cost will accrue to beneficiaries and reduce worseoffness or increase betteroffness.

B. Adoption of a Modified "Family-Based" Filing Unit

Problem: Initially, HEW proposed a broad filing unit composed of all persons related by blood or marriage who live in the same household. Pursuant to your suggestion last May, the initial proposal was modified to allow separate filing status for the aged, blind, and disabled -- as under the current SSI program. Even as so modified, however, the proposal has run into vociferous criticism from both State officials and the social welfare community, and presents the following problems:

- It disadvantages many existing AFDC beneficiaries and in so doing creates incentives for family breakups. For example, under the existing AFDC program, a teenage mother who lives with her parents may file for AFDC benefits with her child regardless of her parents' income and resources. Under HEW's current proposal she would not be permitted to do so unless the entire household, including her parents, was eligible.

- Administration of a family-based filing unit would be somewhat simpler, because there would be fewer filing unit changes and less need to determine whether separate filing status was required to be accorded household members who are economically independent of others in the household. (However, the total number of filing units would increase if a family-based filing unit were adopted.)

- Since the States now administer their AFDC programs based on a family-based unit and favor a family-based filing unit, any move in the Federal program in that direction would further encourage the States to adopt congruent State supplements and thus facilitate uniform administration of the national welfare program.

- A family-based filing unit is used in the income tax system, and a shift in that direction would therefore facilitate coordination of the cash assistance program with the EITC.

Proposal: In the July 25 memorandum, HEW proposed a modified family-based filing unit, which would consist of the nuclear family -- parents and minor children residing in the same household -- and other related unmarried adults who live in that household (except the aged, blind and disabled). Under the July 25 proposal, the so-called "embedded AFDC family" -- the mother and child living with her parents -- would be permitted to file as a separate unit.

At our Thursday meeting, you asked if we could modify the "family-based" filing unit so as to recognize the efficiencies of living in a larger household. We propose a restriction that where two or more filing units reside together, only one receives the $800 "head of household" bonus.* ok

Additional cost: The modified family-based filing unit originally proposed costs $1.0 billion. If the proposed limitation is adopted, then the proposal costs $.7 billion. J

HEW believes that the change to a modified family-based filing unit is important from both a programmatic and political standpoint. It will promote uniformity and simplicity by encouraging congruent State supplementation and by fitting more closely with the income tax system filing unit. It will make a significant dent in the worseoffness problem in the AFDC population and reduce incentives for the split-up of extended AFDC families.

C. Grandfathering of Existing SSI Recipients as to Federal Benefits

Problem: The modified broad filing unit that we adopted following your comments last May (allowing the aged, blind and disabled to file separately) took care of most of the

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* Thus, an AFDC mother with young children would continue to be a separate filing unit, even if she lived within a non-eligible household (e.g., with a non-eligible grandmother). But if the other person in the household were eligible, only one adult would receive "head of household" treatment.

"grandfather" problem for Federal benefits to existing SSI recipients. Under current law, however, SSI recipients who reside with a non-SSI recipient do receive certain special advantages which should not be preserved permanently in the new law. On the other hand, we are reluctant to disadvantage any existing SSI beneficiary who has justifiably relied on current benefit levels. (Note: HEW's proposal already includes a costs for a hold harmless of States that elect to grandfather existing SSI recipients.)

Proposal: The program should be modified to "grandfather' the Federal portion of SSI benefits for existing SSI recipients -- holding them at current benefit levels pending any change in circumstance.

Additional Cost: $100-300 million.

Effect on State Supplements and Fiscal Relief: None

Effect on Recipients: Adoption of this proposal would eliminate all remaining worseoffness among SSI recipients insofar as Federal benefits are concerned. Approximately 100,000-200,000 SSI recipients would benefit from this change.

HEW believes this proposal should be adopted because it will provide fiscal relief for those States that would have grandfathered such filing units and it will protect all SSI recipients against any reduction in Federal benefits.

D. Child Care Deduction

Problem: The current proposal allows for no deduction or reimbursement for day care expenses for working parents. Since the current AFDC program reimburses recipients for actual day care expenses, the current proposal would effectively reduce benefits for single-parent workers who have day care expenses. There are strong pressures to provide additional day care programs or to allow day care deductions to encourage single parents and secondary earners in two-parent families to work. Although the proposed program does not require a single parent to work who has a child under 14, many do work now, with a day care incentive provided by the current AFDC program; many will wish to work under our new program -- and should be encouraged to do so. The child care deduction would provide this encouragement.

Proposal: HEW proposes a standard child care deduction of 20% of earnings up to a maximum \$150/month for single parents receiving cash assistance. This deduction would parallel one in the tax code. The maximum (\$150) was chosen because it equals the level permitted in the proposed tax reform plan for taxpayers. How much more liberal?

Additional Costs: \$.6-.9 billion. ans: less liberal

Effects on Recipients: Approximately 800,000 current AFDC recipients will gain from this change in a total amount of \$.5 billion.

This proposal will make work incentives for single parents much more meaningful; will reduce worseoffness in the AFDC population, and will make the plan more acceptable to women's groups.

E. Federal Sharing in State Supplementation of PSE Wages

Problem: Under our basic proposal, States which elect to provide congruent supplements on the cash assistance side (as we hope and expect they will) are also required to supplement the basic PSE wage provided by the Federal government by 10% (or a total cost of \$320 million). Without some Federal cost sharing in wage supplements, fiscal relief to high-benefit States will be eroded. Because of the higher benefits for which they qualify, single-parent families would cost States which supplement more (since they would be in the "not expected to work" category if the parent's children were under 14) than the cost to supplement two-parent families (who would be in the "expected to work" category). Federal cost sharing would reduce incentives for States to favor the placing of single-parent families in PSE slots to eliminate the need for supplementing them.

Proposal: The Federal government should pay 50% of the cost of the 10% wage supplementation. ?

Additional Cost: \$160 million.

Effect on State Supplements and Fiscal Relief: This proposed change would constitute a further incentive to the States to adopt congruent supplements, and would grant the States fiscal relief in the amount of \$160 million.

Effect on Recipients. None.

Both HEW and Labor support the proposed Federal subsidization of part of State wage supplements, because it provides fiscal relief at relatively modest cost to the Federal government and because it reduces the danger that States will favor single parents over principal earners in two-parent families in filling PSE slots.

F. Payment of Premiums For Work Leaders

Problem: The basic proposal envisions a 25% wage premium to be paid to work leaders in 15% of the PSE jobs. This premium is important to provide incentives to workers in PSE jobs and to make it easier for them to move to meaningful private sector jobs. Under the existing proposal, however, the fiscal burden of this wage premium for work leaders would have to be borne by the States, and that burden would fall most heavily on those States that are currently bearing the highest welfare costs.

Proposal: The Federal government should pay the costs of wage premiums for work leaders as part of the PSE program.

Additional Cost: $300 million.

Effect on State Supplementation and Fiscal Relief: No impact compared to present system, but $300 million fiscal relief to States compared to current proposal. ?

Effect on Recipients: None.

G. Increased Emergency Needs Program

Problem: The May 19 proposal included $600 million for grants to the States for emergency needs programs. Many State and local officials believe that this figure is grossly inadequate in light of the impact of new Federal eligibility rules (particularly retrospective accounting), continued pressure to provide for special needs of recipients, and the need to cover delays in Federal payments.

Proposal: We propose to increase the amount of the block grant to the States for emergency needs to $1 billion. ?

Additional Cost: $.4 billion.

Effect on State Supplements and Fiscal Relief: State supplementation would be unaffected directly, except that additional funds available for emergency needs might reduce the pressure on the States to adopt non-congruent supplements. There would be direct fiscal relief to the States in the additional amount of $400 million.

Effect on Recipients: Overall, recipients would gain $400 million from this proposed change. However, it is difficult to predict how many recipients would be made better off or by how much they will be made better off on the average.

HEW believes that the initial amount allocated for emergency needs -- $600 million -- is indeed probably inadequate, and that a modest increase in the funding is justified.

Decisions:

Earlier in this memorandum we showed that net costs of the welfare reform proposal were +$.7 to +1.3 billion. Assuming savings of $1.3 billion from the requirement that States contribute at least 10% of the program, the net cost of the program is zero to -$.6 billion, excluding any of the program modifications suggested immediately above and excluding the cost of the EITC above the tax entry point.* However, the savings from the new 10% cost-sharing may need to be partially reduced as the result of State-by-State analysis.

We believe that the first four program modifications are essential to the political viability of the welfare reform proposal, and strongly urge their approval. Their cost totals $1.56 to 2.1 billion. We note that while these are listed in HEW's order of priority, DoL would place the day care deduction first.

Benefit for Children Residing with Legally Non-Responsible Relatives ($160-200 million):

✓ Approve (recommended) J

_____ Disapprove

Adoption of the Family-Based Filing Unit ($.7 billion):

✓ Approve (recommended) J

_____ Disapprove

* This has a cost, as previously noted, of $3.6-3.7 billion above the $1.2 billion now absorbed within the "no cost" plan, based on estimated 1979 incomes and tax entry points.

Grandfathering of SSI Recipients as to Federal Benefits ($100-300 million):

__✓__ Approve (recommended)

J

______ Disapprove

Child Care Deduction ($.6-.9 billion):

__✓__ Approve (recommended)

J

______ Disapprove

Three other possible program modifications are presented to you for decision. Adoption of these increments would enhance the acceptability of the program -- but would also increase its cost. Their cost totals: $860 million.

Federal Sharing in State Supplementation of PSE Wages ($160 million):

______ Approve (recommended)

__✓__ Disapprove

Payment of Premiums for Work Leaders ($300 million):

______ Approve (recommended)

__✓__ Disapprove

Increased Emergency Needs Program ($.4 billion):

______ Approve (recommended)

__✓__ Disapprove

Again, no one is recommending the following: reducing the retrospective accounting period from 6 months to either 3 months or 1 month; holding all AFDC recipients harmless; terminating the one-third reduction in benefits for SSI recipients residing in a larger household.

The substance of this memorandum has been reviewed by Sue Woolsey of OMB, and she has no objection.

A

Budgetary Framework

We assume that, for long-run planning purposes, you wish to follow Strategy II as outlined in last month's CEA presentation -- a 1981 balanced high employment budget with total Federal expenditures at about 21 percent of GNP.

According to Strategy II, with some updating, it is possible to have some tax cuts and some new expenditure programs over the next three fiscal years (1979 to 1981), while still balancing the high employment budget. Given (1) current tax laws, and (ii) existing Federal expenditure programs plus those you have already proposed (e.g., energy), a high employment economy in 1981 (4-3/4 percent unemployment and a slowly declining rate of inflation) would produce approximately the following revenues and expenditures:

	FY 1981 (billions of dollars)
Revenues	605
Expenditures	565
"Margin"	50

The CEA presentation on July 8 assumed that this margin would be divided between $20 billion of expenditure increases (leaving Federal expenditures at 21.2 percent of GNP) and $30 billion of tax cuts.

Estimates of the budget margin four years down the road are very imprecise. Among other things, the size of the margin depends importantly on the rate of inflation. A higher rate of inflation than we have assumed in our long-range economic forecasts could raise the margin.

Uses of the Margin

1. Adoption of the entire set of options in the last Treasury tax reform presentation would cost $28 billion in 1981. The new earned income tax credit, as proposed by HEW, would reduce revenues by an additional $3.5 billion in 1981. All together, therefore, the two proposals taken together would cut revenues in 1981 by $31.5 billion, fully using up the room for tax cuts. (The estimates are so rough that the difference between $31.5 and $30 billion is not significant.)*

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* Note: This raises the following separate problem. We will not want $28 billion of net tax reduction to come all at once. If the tax reform is planned to take effect on January 1, 1979, we should plan to phase in the net reduction over two or three years. Moreover, the timing of the net reductions should depend upon the state of the economy. Hence we will need to design a phasing system which can be easily modified as we monitor economic events in 1978 while the bill is going through Congress.

2. On the expenditure side the $20 billion "room" for expansion is itself shaky. OMB projections assume that expenditures on existing programs are not increased to cover inflation except where required by law, where needed to pay for direct purchases of goods and services (principally Defense), and in a few other cases. The failure to cover inflation particularly affects grants to State and local governments, and implies a declining real value of Federal fiscal support for such things as education, manpower training and health services. OMB estimates that expenditures would be roughly $10 billion higher in 1981 if inflation were taken into account fully. Some of the programs affected by inflation could be cut back in real terms. If you assume that a combination of policy reasons and political pressure dictates that we meet half of the inflation "need," then the net margin for expenditure increases is $15 billion rather than $20 billion.

3. The fate of the energy program on the Hill could substantially change these numbers:

(i) The well-head tax will yield about $9 - $10 billion in 1981. Since we originally promised to pass it back to consumers in the form of per capita (or per family) tax credits and transfer payments, HEW is applying $1.3 billion to its welfare program (e.g., the money will be returned to the poor in the welfare program not in separately identified per capita transfers). The Ways and Means Committee has provided for rebates only in 1978, leaving open how the funds are to be used in later years. One way or the other, however, they must be mainly used for still further tax reductions and not to fund new programs, or the 21 percent constraint will be violated.

(ii) The House is in the process of passing an energy bill with less revenues and more expenditures than you recommended.

- This could reduce the 1981 "margin"
- but, the amounts in that year are small
- and, to the extent that some of the 5 cent gasoline tax is used to fund outlays that would have occurred anyway, the margin is not disturbed.

4. There are various "threats" to the expenditure margin: a more expensive farm bill; an HEW appropriations at least moderately over the budget; additional outlays for the South Korean armed forces, etc. While the worst of these can be thwarted, it would be unrealistic to assume zero slippage.

5. To the extent that zero-based budgeting can come up with savings that are not reassigned to the agency making the saving, budgetary resources will be freed up to add to the margin.

Conclusion

Given the very great uncertainties -- in the estimates, in the pressure to cover inflation in grant programs, in the fate of the energy package, in the magnitude of savings from zero-based budgeting -- it would be prudent, at this stage, to assume that no more than $10 to $15 billion of expenditure margin will be available in 1981. This must accommodate the first phase of health insurance, some outlays (probably modest) for fiscal aid to cities, as well as any added outlays on welfare reform over and above the zero-cost program. With good breaks, and significant savings from zero-based budgeting, that margin could widen. But between now and 1981 there will surely be new needs, emergencies, and opportunities to contend with. Over the next year, therefore, we certainly shouldn't commit to added 1981 expenditures beyond $10 billion.

Summary of 1981 Budget Margin

Total	50	
Tax reductions	30	
. Full Treasury reform package	28	
. Added earned income tax credit		3-1/2
Expenditure increases	20	
. Allowance for inflation in current programs	5	
. Contingency for future threats, needs, etc.	5	
. Expenditure leeway for current decisions	10	

THE WHITE HOUSE
WASHINGTON

August 1, 1977

Stu Eizenstat
Jack Watson

The attached is for your information.

Rick Hutcheson

RE: WELFARE REFORM DECISION MEMO

2 2

8/4

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

August 1, 1977

MEMORANDUM FOR THE PRESIDENT

From: Charlie Schultze

This was attached to the welfare reform decision memo. I am sending it to you in case you did not get a chance to see it, since it may be useful in other contexts.

Attachment

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